Product Outline: Musharakah Mutanaqisah (Asset Financing)

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Policy Owner	Head of Islamic Banking Division

Approved by DAB Governor:	Date	DAB Board Secretary ....

Contents

ISLAMIC REPUBLIC OF AFGHANISTAN

DA AFGHANISTAN BANK, PRODUCT OUTLINE – MUSHARAKAH MUTANAQISAH (ASSET FINANCING)

PART A: PREAMBLE

1 Background

1.1. This product outline for Musharakah Mutanaqisah (Asset Financing) (hereinafter referred to as "the Product Outline") is issued by the Da Afghanistan Bank (hereinafter referred to as "DAB") which shall be adopted and become the guiding principles for Islamic Financial Institutions, Financial Institutions operating with an Islamic Window and Financial Institutions operating with an Islamic Unit (collectively referred to as "the Bank") in the Islamic Republic of Afghanistan offering Islamic financial products.

1.2. This Product Outline is intended to:

1.2.1 Enable Banks to develop their own Musharakah Mutanaqisah (Asset Financing) products using this Product outline as a baseline for the product development process; and

1.2.2 Illustrate to the Bank global best practices in adopting the Product Outline.

1.3. The objectives of this Product Outline are to:

1.3.1 Facilitate the development of Musharakah Mutanaqisah (Asset Financing) products in Banks in the Islamic Republic of Afghanistan; and

1.3.2 Establish a precedent Product Outline that the Banks shall use when developing and operationalising their own Ijarah (Asset Financing) products.

1.4. Any particular exemption to any of the provisions as provided herein shall only be permitted via a formal application being submitted by the Bank after prior consultation with its Shariah Board (hereinafter referred to as "the Shariah Board"), to the Shariah Supervisory Board of DAB (hereinafter referred to as "the SSB") outlining the reasons and justifications for such requests.

1.5. If any new or additional guidelines on the Product Outline are to be adopted, the Shariah Board of the Banks shall always be consulted first before the adoption of same.

2 Legal Provision

2.1. This Product Outline is issued pursuant to Article 2.2 of the Afghanistan Bank Law gazetted on 12/17/2003 (corresponding to 30/10/1382) in relation to the powers of DAB to regulate and supervise Banks in the Islamic Republic of Afghanistan and any amendments thereto.

2.2. This Product Outline shall be read together with the following manuals/guidelines:

- 2.2.1. National Shariah Governance Framework;
- 2.2.2. Musharakah Shariah Parameter;
- 2.2.3. Ijarah Shariah Parameter;
- 2.2.4. Ijarah (Asset Financing) Product guide;
- 2.2.5. Shariah Review Manual;
- 2.2.6. Shariah Compliance Manual;
- 2.2.7. Guidelines on Ibra;
- 2.2.8. Guidelines on Late Payment Charges; and
- 2.2.9. Other relevant regulations guidelines, Product Outlines or circulars that Da Afghanistan Bank ("DAB") may issue from time to time.

PART B: PRODUCT OUTLINE – MUSHARAKAH MUTANAQISAH (ASSET FINANCING)

3 Overview

3.1 Definition of Musharakah

3.1.1 Musharakah is a contract between two parties to contribute capital to an enterprise or a venture, whether existing or new, or to the owner of a real estate or moveable asset, either on a temporary or permanent basis.

Profits generated by that venture or asset are shared in accordance with the terms of the Musharakah agreement, while losses are shared in proportion to each partner's share of capital.

3.1.2 There are two types of Musharakah, namely Shirkah al-Aqd (commercial partnership) and Shirkah al-Milk (co-ownership). Shirkah al-Aqd refers to partnership with commercial objective, whereas, Shirkah al-Milk refers to a co- ownership in a particular asset. Each of these classifications would have different salient features. Modern application of Musharakah may take the form of Musharakah investment or Musharakah financing, as the case may be.

One of the common Musharakah applications in asset financing is Musharakah Mutanaqisah (diminishing co-ownership). The essential features attributable to a Musharakah contract are capital, management, profit sharing, loss sharing and a joint venture.

3.1.3 Musharakah Mutanaqisah ("MM"), is a co-ownership contract between two parties on a specific venture where both parties in the venture agrees that one party will be allowed to redeem the shares/ equity of the other party either gradually or on a lump sum basis.

In MM property financing, the customer and the Bank jointly acquire and own the property. The Bank then leases its share of the property to the customer on the basis of ijarah (leasing). Based on this premise, MM which is meant to facilitate property financing is more akin to Shirkah Al-Milk (co-ownership). Thus all the subsequent requirements and clauses will be based on this principle as the purpose of this venture is essentially to co-own the property and not to generate a commercial gain.

3.2 Shariah Resolutions on Musharakah Mutanaqisah

3.2.1 Shariah Advisory Council (SAC) of Bank Negara Malaysia (Central Bank of Malaysia) has passed a resolution allowing Musharakah Mutanaqisah to be used as a valid financing contract under Islamic financing schemes. The resolution is as follows:

"The council in its 56th meeting held on February 2006/7 Muharram 1427 resolved that the financing product structured based on Musharakah Mutanaqisah contract is permissible. This is because the Musharakah Mutanaqisah contract is a contract recognised by Islamic Muamalat"

In implementing Musharakah Mutanaqisah contract, it is permissible for the contracting parties to:

i) Combine the two contracts of Musharakah and Ijarah in one document of agreement, as long as both contracts are concluded separately and clearly not mixed between each other; and

ii) Impose a pledge on shares owned by the Customer because the right of beneficial ownership is recognised by Shariah."

3.2.2 The Accounting and Auditing Organization for Islamic Financial Institutions ("AAOIFI") i.e. the body responsible for developing accounting, auditing, ethics, governance and Shariah standards for the international Islamic banking and finance industry, has also recognised the Musharakah Mutanaqisah contract to be used as a valid contract in Islamic finance.

AAOIFI has included the Musharakah Mutanaqisah contract in its Shariah Standard No. (12).

4 Product Features

4.1 Parties in a Musharakah Muntanaqisah Arrangement

MM arrangement will consist of three (3) parties:

4.1.1 The Vendor (the Developer or Property Owner);

4.1.2 The Bank; and

4.1.3 The customer, who is in need of cash for home financing

4.2 The Fundamental Features of Musharakah Mutanaqisah

4.2.1 Capital

i) The capital should be contributed to the partnership venture by both parties in the form of monetary assets in which one can rely in order to determine the amount of capital and to recognize the profit or loss. However, it is permissible, subject to mutual agreement of all partners, to inject tangible assets (commodities and properties) as the capital for an MM venture provided the valuation of these assets is being ascertained in monetary form.

ii) If cash capital contributed is in multiple currencies, these currencies must be converted into the currency of the MM venture so as to determine the shares and liabilities of each partner based on a particular currency.

iii) The share of each partner in the capital to be supplied for the venture shall be clear from the outset although the parties may mutually agree that the capital can be contributed to the venture in one lump sum or over a certain period of time.

iv) Debts are not qualified to be considered as capital. Funds in current accounts may be presented as capital contribution only when the funds are drawn and transferred to the Musharakah account.

v) The distribution of profit in an MM venture must be based on the actual profit generated by the venture. Projected or anticipated profit may be distributed but will be subject to a claw back provision based on the actual profit generated by the venture if same is below the projected profit. In the event of additional

vi) In the event of additional profit being generated by the venture over and above the projected profit, same will be shared in accordance with a pre-agreed profit sharing ratio.

vii) It is not required that the capital of the Musharakah must be mixed together or be present at the time of contract. However, the capital must be specified and available for draw down as and when required by the Musharakah venture.

4.2.2 **Profit Sharing Ratio**

i) The parties to an MM venture shall be required to pre-agree a profit sharing ratio between themselves prior to initiating the venture. The partners are free to adopt any profit sharing formula they wish. This is a commercial decision between the parties.

ii) Profit in an MM venture must be described in terms of rate or ratio and not in terms of a fixed amount. It is not permissible to assign a lump sum amount of profit to any of the partners.

iii) The profit sharing ratio must be determined and agreed upon at the time the Musharakah contract is executed. The determination and distribution of profit must be based on the actual profit generated by the business/venture and not in the proportion of the capital contributed. It is not permissible to have any rate of profit attached or tied up with any partner's capital contribution.

iv) It is not permissible to distribute profit in an MM venture unless all operating costs, expenses and taxes are deducted in calculating profit and the capital contributed to the venture by the partners remains intact.

v) Subject to the agreement by all parties in the venture, it is permissible for a partner to be paid for his share of the profit in advance provided that the amount is clawed back or refunded by the partner to the venture at the actual time the profit is distributed between all the partners of the venture in the event of a shortfall in profit generation.

4.2.3 **Loss Sharing**

i) Loss in an MM venture must be shared according to capital contribution ratio of each partner i.e. each partner shall incur loss according to their respective capital contribution ratio. For example, a partner who contributed 40% of the capital shall bear 40% of the losses incurred by the venture.

ii) Loss in an MM venture would also include borrowings or debts owing to third parties arising from the MM venture.

iii) For Example – Venture A has a paid up capital fund of $10 million USD. The PSR is 25/75 between Partner A and Partner B in favour of Partner A. Partner A contributed $1 million and Partner B contributed $9 million to the venture.

The venture suffers a loss of $2 million in its first year. The fund now has a value of $8 million

There is no Profit so the PSR is irrelevant.

Partner A bears 10% of the $2,000,000 loss ($200,000) in line with his **capital** contribution of 10% ($1,000,000) so his interest in the fund is reduced from $1,000,000 to $800,000.

Partner B bears 90% of the $2,000,000 loss ($1,800,000) in line with his **capital** contribution of 90% ($9,000,000) so his interest in the fund is now reduced from $9,000,000 to $7,200,000.

4.2.4 **The Management**

i) Each partner in the venture has the right to participate in the management of the venture. However, it is permissible that the partners agree that the management of the venture is to be undertaken by a certain partner.

ii) The appointment of a manager(s) of the venture among the partners must be independent from the MM contract. The partners should have the right to terminate or replace the manager without having to dissolve the co-ownership arrangement.

iii) The managing partner(s) are entitled to be compensated for managing the venture either through fixed remuneration or additional portion to the profit sharing ratio which shall be agreed upfront

iv) It is also permissible for all the partners to agree that the venture is managed by a third party with certain remuneration which will be accounted for as expenses of the venture.

v) If the venture is managed by all the partners, the decision of each individual partner is deemed to be the collective decision of all the partners.

vi) If the venture incurs losses under the management of one the partner, the manager should not bear the loss alone but the loss must be borne by all the partners in the MM venture except in a situation where the loss is caused by the misconduct, negligence or fraud of the manager.

4.2.5 **Ijarah in MM Home Financing Facility**

i) Ijarah contract is also part of an MM Home Financing facility where Ijarah contract is concluded between the customer and the Bank for the customer to have the usufruct (right to use) the property.

5 Product Structure and Process flow

5.1 Musharakah Mutanaqisah contract which is based on a diminishing co-ownership contract in the home financing transaction consists of three portions to the contract.

5.1.1 First, the Customer enters into a co-ownership (Musharakah) under the concept of "Shirkah-al-Milk" (co-ownership) agreement with the Bank. Customer pays, for example, 10% as the initial share to co-own the property whilst the Bank provides for the balance of 90%. The customer will then gradually redeem the bank's 90% share at an agreed portion periodically until the property is fully owned by the customer.

The significance of Shirkah Al-Milk (co-ownership), in contrast to Shirkah Al-'Aqd (partnership), is that co-ownership manifest a non-commercial motive of the two partners whereby both parties enter into this Musharakah to simply co-own a property. It was not the intention of both parties to trade in this property. On the contrary, one of the partners i.e. the Bank/financier, will lease his portion of shares in the jointly acquired property to another partner for him to benefit from the usufruct of the property until some time when the shareholding of the bank/financier will be eventually redeemed and the property ownership is transferred to the customer.

5.1.2 Second, the Bank leases its share (90%) in the property ownership to the customer under the concept of ijarah, i.e. by charging rent; and the customer agrees to pay the rental to the Bank for using its share of the property. The periodic rental amounts will be due to the Bank according to its percentage of shareholding at a particular point in time. Technically, the customer's share ratio will increase after each rental payment due to the periodic redemption of the Bank's share and this will continue until the total share of the Bank is eventually owned by the customer via redemption.

5.1.3 Third, there is also a Wa'd (undertaking) to purchase the asset the shall be executed by the customer at inception of the facility whereby the customer undertakes to purchase the Bank's entire interest in the property upon termination of the Ijarah or upon default by the customer on payments required under the Ijarah.

5.2 The general conceptual flow of MM property financing is as follows:

5.2.1 A customer who intends to own a property purchases a property from a vendor with part payment;

5.2.2 The customer, due to shortage of funds to pay the full selling price to the vendor, finds a financier/ Bank who is willing to co- finance the purchase of the property from the vendor;

5.2.3 The Bank provides financing (subject to internal credit approval) by contributing the required financing amount representing the equitable rights in the property to pay the outstanding amount of the full selling price to the vendor;

5.2.4 Both, the Bank and the customer co-own the property by virtue of the Bank paying the remainder of the sale price to the vendor. A co-ownership of the MM contract is concluded between the customer and the Bank;

5.2.5 Under Ijarah, the co-ownership may rent the whole shares of the jointly acquired property to the customer or only the Bank rent its portion of the shares to the customer for an agreed rental payment and schedule.

5.2.6 The customer undertakes to gradually redeem and the Bank undertakes to allow the gradual redemption of the equitable rights in the property from the Bank through a periodic rental payment schedule over a determinable period of time;

5.2.7 The customer then makes the payment to the Bank as per agreed schedule to gradually redeem the equitable rights in the property held by the Bank as well to pay payment to enjoy the usufruct of the property at a rate agreeable by both the customer and the Bank;

5.2.8 The customer will also undertake to make sure that the asset is in a good condition and any expenses incurred which relates to the property will be borne by the customer;

5.2.9 At the end of the agreed tenure, when all the equitable rights of the Bank have been redeemed by the customer through the agreed payment plan, the property will belong solely to the customer.

6 Suggested Documentation

The legal documentation for the Product will depend on the actual structure to be adopted by the Bank and the Bank's internal policies and procedures as advised by the respective Bank's legal counsel:-

Below are among the particulars needed from a customer at the legal documentation for an MM financing product:

6.1. Application form

a) Name of the customer;

b) Personal details (address and other information of the customer);

c) Employment/business details;

d) Description of the asset;

e) Purpose of financing requirement;

f) Amount of finance required;

g) Bank account details;

h) Details of already availed finances;

i) Details of joint applicant (if any); and

j) Any other important particulars as deemed necessary.

6.2 **Undertaking to gradually purchase the asset from the Bank's equity portion**

a) Name of the customer;

b) Asset details;

c) Rent/Sale price of the asset;

d) Profit rate;

e) Guarantee by third party (if any); and

f) Any other important particulars as deemed necessary.

6.3 **Local purchase order**

a) Name of the Seller/Manufacturer;

b) Asset details;

c) Sale price of the asset;

d) Terms of delivery; and

e) Any other important particulars as deemed necessary.

6.4 **Ijarah contract**

a) Name of the parties to the contract i.e. Lessor and Lessee;

b) Date of contract;

c) Total price of the asset, cost incurred and profit;

d) Lease term;

e) Terms and mode of payment;

f) Terms for delivery of the vehicle;

g) Terms for use of lease asset;

h) Roles and responsibilities of each party to the contract;

i) Clause for termination of contract;

j) Laws applicable to the contract;

k) Legal recourse clauses; and

l) Any other important particulars as deemed necessary.

6.5 **Payment schedule**

a) Name of customer;

b) Date of first rental due;

c) Amount of monthly rental;

d) Date of rental payment;

e) Grace period days (if any); and

f) Any other important particulars as deemed necessary.

6.6 **Promise to Sell** in the event of early pre-payment of the Termination Price as outlined in the Ijarah documentation.

7 Suggested Accounting Entries

7.1. Collection of Processing Charges

DR. Cash at Hand/Customer's Account (B/S)

CR. Processing Charges (P&L)

7.2. On Receipt of Customer's Share

DR. Cash in Hand/ Customer's Account (B/S – Asset/ Liability)

CR. Customer Share in MM (B/S – Liabilities)

This entry will be passed in cases where the customer pays the Bank his share for onward payment to the seller/vendor/contractor. This will not be passed in case customer pays directly to contractor.

7.3. At the Time of Disbursements to Vendor/Contractor/Seller (One-Off or Multiple when the Asset Will Be Delivered at a Future Date)

DR. Advance against MM a/c. (with Bank's share only)

CR. Pay Order Issuance/ Contractor's Account/Vendor's Account/Seller's Account (B/S)

7.4. In Case of Multiple Disbursements the Entry Will Be Repeated and the Advance Amount Will Be Updated

DR. Customer share in MM

CR. Pay Order Issuance/ Contractor's Account/Vendor's Account/Seller's Account (B/S)

7.5. At the Time of Booking of MM Asset (Upon Delivery of Asset)

DR. MM Finance a/c. *(wih Bank's share only)*

CR. Advance against MM a/c. *(with Bank's share only)*

7.6. **In Case of Further Disbursements While Booking of MM Asset or After the Delivery of MM Asset for Instance in Case of SLB (The MM Finance A/C Shall be Updated With the Difference)**

DR. Advance against MM a/c. *(with difference amount)*

CR. Pay Order Issuance/ Contractor's Account/Vendor's Account/Seller's Account (B/S) *(with difference amount)*

DR. MM Finance a/c. *(with difference amount)*

CR. Advance against MM a/c. *(with difference amount)*

7.7. **At the Time of Payment of Insurance and Registration Charges**

DR. Prepaid Takaful / Insurance Account (with Customer tagging) (B/S – Asset)

DR. Prepaid Registration Account (with Customer tagging) (B/S – Asset)

CR. Cash in Hand/ Pay Order Issuance (B/S)

7.8. **Accrual of Income (during gestation period and after delivery)**

DR. MM Rental Receivable (Profit)

CR. Income on MM Financing

7.9. **Collection of Rental**

DR. Customer Account

CR. MM Rental Receivable (Profit)

7.10. **At the Time of Unit Purchase (Collection of Principal)**

DR. Customer Account

CR. MM Finance a/c

7.11. **Collection of Prepaid Takaful / Insurance and Registration Charges**

DR. Cash in Hand/ Customer Account (B/S – Asset/ Liability)

CR. Prepaid Takaful / Insurance Account (B/S – Asset)

CR. Prepaid Registration Account (B/S – Asset)

7.12. **Early Termination During Advance against MM stage**

DR. Cash in Hand / customer's account (B/S) (balancing figure)

CR. Advance against MM

7.13. **Return of rental and reversal of accrual in case of termination during advance stage.**

DR. Income on MM Financing

CR. Customer Account

CR. MM Rental Receivable.

7.14. **Early Termination of MM**

DR. Cash in Hand/ Customer's Account (B/S) (balancing figure)

CR. MM Finance a/c. (B/S – Asset)

CR. Prepaid takaful/ Insurance Account (Balance amount recoverable)

CR. Prepaid Registration Account (Balance amount recoverable)

CR. MM Termination Charges (Income on Termination)

7.15. **Charity recoverable in case of delay in payment by the Customer**

(a) DR. Charity receivable from customer (B/S – Asset)

CR. Charity fund payable (B/S – Liability)

(To record accrual of penalty/ charity for delay in payment by the customer)

(b) DR. Cash in Hand /customer's Account (B/S – Asset/ Liability)

CR. Charity receivable from customer (B/S – Asset)

(To record collection of Penalty/ Charity from Customer)

(c) DR. Charity fund payable (B/S – Liability)

CR. Cash in Hand/ Bank Account (B/S – Asset)

(To record payment of Charity collected as per approval of the Shari' a Supervisory Board)

Note:
The accounting entries above are suggestions only. The actual accounting treatment will depend on the actual product structure developed by the Bank.

8 Risks Associated with the Product

8.1 General Risks:

8.1.1 **Credit Risk:** Credit Risk of the customer. Bank to use prudent risk management tools to ensure that only good credits are approved for the MM product. Bank may require additional security from customer as collateral for the financing.

8.1.2 **Market Risk:** There may be Market risk due to the particular nature of the financed assets (especially automobiles). Banks to ensure that adequate level of earnest deposit is paid by the customer to ensure that the Bank's exposure to market risk is limited. Suggest that Bank has a financing cap specifically for automobile financing as part of its credit policy.

8.2 Operational Risk:

8.2.1 **Process risk:** Strong Know Your Customer ("KYC") controls, complete Management Information System of the transactions and daily logs will reduce the processing risk.

8.2.2 **Documentation risk:** Relationship Manager to ensure that complete documents are obtained from the customer.

8.2.3 **Loss of security documents:** Central Operations will ensure safe keeping of the documents under dual custody in a fire proof cabinet. The complete details will be entered in the lodgement register.

8.2.4 **KYC and Money laundering risk:** Business unit to ensure compliance with all requirements in the money laundering prevention, local regulations concerning KYC and account opening procedures.

8.2.5 During the trading process the concerned users need to ensure that correct amount is communicated to the trading desk for purchase and sale of commodity.

8.2.6 **Compliance Risk:** Compliance department to ensure that necessary Central Bank regulations are communicated to appropriate divisions for implementation.

8.2.7 **Shariah Risk:** The implications of Shariah non-compliance and risks associated with the Bank's fiduciary responsibilities towards different customers would expose the Bank to customers' withdrawals, terminations or voiding of contracts. This in turn could lead to a diminished reputation and / or the limitation of further business opportunities for Bank in this sector. Shariah compliance is critical to the Bank's Islamic operations and such compliance must permeate throughout the organisation.

Shariah compliance is the highest priority in relation to all other identified risks concerning this product.

8.3 **Specific Risk Matrix**

Risk category & nature of risk	Mitigating factors
Customer Level Risks	
i) Insufficient cash flows for payment of rentals	Analysis of customer's income stream
	Obtain last six months bank statements to review the number of transaction and average balance.
	Calculate Debt/Burden Ratio.
iii) Death and disability of the customer	Obtain takaful or in its absence insurance coverage
	There is cap on maximum age limit i.e. 65 years
iii) Loss of employment	Minimum experience of 2 years is required to be eligible for obtaining home finance. With 2 year's experience, there is higher possibility to get alternative employment
iv) End use of funds	In case of financing of a vehicle, the payment is made directly to the seller/financial institution through

	DD/Pay Order/Cross Cheque.
Documentation Risks	
i) Incomplete documentation	Obtain all the common and salary/business related documents as stated in the manual and all charges/collateral documents as stated in the credit approval manual and ensure completeness in all respect before disbursement.
ii) Incomplete security documents	Credit Administration Officer ("CAC") shall ensure that all security documents have been obtained as per terms of the offer letter. The Offer Letter must contain all the Legal Agreements required for MM Facility. CAC must ensure to have all the MM Agreements before disbursements, after disbursements and during the facility like Sale Receipts.
iii) Loss/Damage of security documents	All security documents shall be kept in fireproof cabinets under dual custody Maintaining the Safe-in and Safe-out Register
Quality Related Risks	
i) Customer fraud	The risk of ghost customer will be mitigated by putting in place a series of strict evaluation criterion met by bank staff/external agencies; including credit reports and telephonic and physical verification of customer's given details
ii) Employee fraud	Establish a set of internal controls to prevent and detect fraud.
	Tools of segregation of duties shall be employed to mitigate the risk
	Marketing, processing, authorization, disbursement and recovery procedures to be performed by different individuals
iii) Loss of computerized data	Daily back up by systems department

	Ensure contingency planning
iv) Trained human resources	Appropriate training of the customer facing staff, to ensure correct understanding of the products and to avoid misinterpretations and misunderstandings about Islamic banking products. Career planning of the supporting staff along with satisfaction of existing staff.
Credit Related Risks	
i) Default risk	Establish "Know Your customer" (KYC) mechanism
	Maintain continuous interaction with the customer for timely recovery of monthly rental payments
	Creation of provisions as per Banking laws and accounting policies
	Obtain collateral to secure the payment in case of default
	Have an aggressive credit evaluation process to evaluate the customer's financial capability and credit worthiness
ii) Profit rate risk	Bank is exposed to profit rate risk for short term only as rentals are calculated using variable rate changeable after every 12 months
	Floor rate is agreed with the customer
	The option is available to the customer to adopt fixed or floating profit rates and flexibility to switch from floating to fixed rate or vice versa.
iii) Security risk	Ownership of the asset will remain with both the Bank and customer during the lease/gradual purchase term
	Title documents will remain under the Bank's safe custody during the lease term
	Undated cheques or debit instructions to be received

	from the customer to secure the monthly rentals
iv) Risk of the property	In the event of any loss in the asset / property due to any natural disaster or full collapse. The Bank will recover the outstanding amount from the Takaful/insurance company since all properties to be covered by proper Takaful/ insurance.
v) Monthly payment stoppage	In case the asset property collapse, rental payments will be stopped, as due to non-availability of assets, rent cannot be charged.
vi) Customer defaults after signing the Promise to Lease	The Bank will sell the asset in the open market to recover the loss. The difference between the promised to purchase price and the Bank's selling price will be considered as the actual loss.
	The Bank will recover the actual loss from the customer by enforcing the security, including but not limited to security deposit given by the customer.
Other Risks	
i) The asset is not constructed as per the agreed specifications and timelines- In case of construction case.	In case of conflict, the Bank may sell the asset portion owned by Bank in the open market to recover the cost of the asset any actual loss incurred will also be recovered from the customer.
ii) Customer refusal to take on lease	The Bank will sign the "Promise to Rent (Ijarah) Agreement" with the customer.
iii) Major maintenance cost	The Bank should agree with the customer for the payment of any supplementary rentals in full which may occur for the purpose of maintenance.
	If the maintenance is due to the customer's fault then the customer will pay the full cost, however if the maintenance is due to the Bank's fault then during that time the Bank will not charge rental for customers.

9 Product Pricing

9.1 The following factors are considered when pricing is structured for a product:

a) Tenor

b) Processing fee

c) Security deposit (%)

d) Profit rate (%)

e) Early terminaton charges

f) Repossession charges

g) Cheque return charges

h) Charity on account of late payment

9.2 **Pricing Structure**

9.2.1 Minimum and maximum amount available under the MM facility should be clearly determined.

9.2.2 Lease rentals can be calculated using fixed profit rate or variable profit rate. The customer will be given option to switch form fixed profit rate to variable and vice-versa.

9.2.3 **Floating/ variable profit rate**

a) The Profit Rate under this option shall be linked to a certain benchmark rate mechanism such as the London Interbank Offered Rate (LIBOR). Any change in the LIBOR shall have a bearing on the monthly payment of rent of the property.

b) The 'Cap Rate' and 'Floor Rate' are the agreed rates for the entire tenure of the Ijarah investment.

c) In case of 'Floor Profit Rate', if LIBOR is reduced, the profit rate shall not be less than the agreed Floor Profit Rate.

d) The Standard Variable Profit Rate shall be as follows:

Minimum Profit Rate: x % over 01 Year LIBOR

Floor Profit Rate: x % p.a.

Cap Profit Rate: x % p.a.

9.2.4 **Fixed Profit Rate (FPR)**

a) Under the Fixed Profit Rate basis, the monthly rental is calculated at an agreed profit rate for a defined period.

b) There shall be no conversion charges for switching over from Fixed Profit Rate to Standard Variable Profit Rate.

9.2.5 The customer shall undertake to pay certain amount by way of Charity, agreed with the customer at the time of execution of Ijarah contract, in case of late payment or default by the customer.

9.2.6 The customer shall deposit such amount in Charity Accounts maintained at the Bank branches solely for this purpose after deducting the actual cost incurred for recovery of rentals/default.

9.3 Basis of calculation of lease rentals

The following factors are considered when deciding the lease rentals:

9.3.1 Treatment of security deposit

The amount of security deposit should be deducted from the Principle Amount (Cost of asset) while calculating the monthly rental amount.

9.3.2 Principle amount

The Principle Amount (deductible of the security deposit amount) should be amortized over the lease term by using rate of profit as mentioned in Ijarah Application (in line with bank policy).

9.3.3 Takaful/insurance premium

Takaful/insurance premium should be amortized on yearly basis by using rate of profit as mentioned in Ijarah Application (in line with bank policy).

9.3.4 Grace Period Profit

Grace period profit should be calculated using the following formula:

<u>Principle Amount x Rate of Profit x No of days outstanding</u>

*Number of days outstanding should start from date of disbursement until the date of first rental due.

10 Common mistakes

10.1 Failure to ensure that Fatwa issued by the Bank's Shariah Board for the Product before offering to clients. Shariah secretariat to confirm with Business Units that the product may be offered to customers.

10.2 Inadequate or non-existent documentation – this may render the transaction void *ab initio*.

10.3 Incorrect document process flow – this may render the transaction void *ab initio*.

10.4 Restructuring of an Ijarah term and payment schedule and increasing/decreasing the amount payable by the customer. The Bank and the customer may, upon their mutual agreement, increase/decrease the tenor and price of the financing facility. For instance, if a customer is in difficulty with their payments, the Bank may offer another facility with a longer tenor and at a lower rental price but this must involve a totally separate new contract based on the new value of the asset at that particular time of restructuring.

10.5 Adding Late payment fees to the Bank's profit account. The Bank's actual costs due to the customer's late payment only may be taken by the Bank, the balance (if any) must be channelled to charities previously approved by the Bank's Shariah Board.

10.6 Incomplete records of the sources of payments to charities.

10.7 Agreeing a rebate (if any) with a Customer in advance of providing the facility or in advance of an early settlement request issued by the customer.

11 Custodian of the Product Outline

11.1 This Product Outline shall be under the safe custody of the Islamic Banking Division ("IBD") of DAB. Any changes to this Product Outline shall be made by the IBD with prior consultation with the SSB, as reviewed by the DAB Executive Board and upon approval by DAB Supreme Council. A copy of the amended Product Outline shall be made available to all stakeholders and SSB members for reference and implementation.

11.2 Banks may further refine the Product Outline to suit their particular structure and policies. Such amendments shall be approved by the Bank's Shariah Board. The Bank's Shariah Department/Islamic Banking Department/Unit will have custody over the Bank's Product Outline for Musharakah Mutanaqisah financing.

12 Effective Date of the Document

The Effective date of this Product Outline is the ______ day of ______________ 20___